

PHILLIPS PETROLEUM CO.

IBLA 87-516

Decided May 9, 1989

Appeal from a decision of the Assistant Director, Minerals Management Service, affirming an assessment of late payment charges for royalty payments timely paid but erroneously credited to the parent lease rather than the lease segregated therefrom on partial commitment of the lease to a unit agreement. MMS-86-0024-O&G.

Reversed.

1. Federal Oil and Gas Royalty Management Act of 1982: Royalties--Oil and Gas Leases: Royalties

When only a part of a producing oil and gas lease is committed to a unit agreement, the uncommitted portion is segregated into a new lease and given a new lease number. An assessment of late payment charges will be reversed where the royalty was timely paid but initially credited to the account of the parent lease rather than a segregated lease created by partial commitment of the parent lease to a unit agreement and the misidentification was the result of delay in notifying the payor of the segregation and the new lease number for the segregated lands.

APPEARANCES: Jennifer A. Cates, Esq., Bartlesville, Oklahoma, for appellant; Peter J. Schaumberg, Esq., and Howard W. Chalker, Esq., Office of the Solicitor, U.S. Department of the Interior, Washington, D.C., for the Minerals Management Service.

OPINION BY ADMINISTRATIVE JUDGE GRANT

Phillips Petroleum Company has appealed from a March 24, 1987, decision of the Assistant Director, Minerals Management Service (MMS), denying its appeal of the assessment of late payment charges for royalties timely paid but erroneously credited. The basis for the MMS decision was that appellant, by initially identifying the wrong lease number for the payments and subsequently attempting to correct the misidentification, was effectively seeking to offset an overpayment on one lease against an underpayment on another lease. This practice is not permitted by MMS.

In July 1987, appellant filed a request for a hearing. The Board denied the request as a preliminary matter by order dated September 9, 1987, but took the request under advisement pending further consideration of the appeal on the merits. Because we find that there are no remaining issues of material fact unresolved by the record which warrant an evidentiary hearing, appellant's request for a hearing is denied.

Appellant reported and paid \$7,544.57 in royalties for Federal onshore oil and gas lease 48-0266642-0, and \$1,288.80 in royalties for Federal onshore oil and gas lease 48-266641-0, for the production month of June 1984. In July 1984 appellant received a copy of Bureau of Land Management (BLM) letter/decisions advising that certain acreage in both of those leases had been segregated in May 1983 due to the commitment of part of the lands in each lease to the Brahman unit agreement. The letter/decisions also provided new lease numbers for the segregated leases embracing the uncommitted lands. Although the BLM letter/decisions recognizing the segregation of the leases were dated June 21, 1983 (for lease W-0266641) and June 29, 1983 (for lease W-0266642), there is no indication that copies of the decisions were served by BLM on appellant. Further, there is no evidence in the record to rebut appellant's assertion that it did not receive notice of the segregation and the newly assigned lease numbers prior to July 1984. <sup>1/</sup>

Thereafter, appellant filed with MMS payor information forms (PIF's) reflecting the segregation of the leases and the new numbers assigned. By payor confirmation reports (PCR's) dated July 29 and August 12, 1984, MMS assigned new accounting identification (AID) numbers to the segregated lease accounts.

In February 1985, appellant filed revised royalty reporting forms (MMS Form-2014) for the month of June 1984 for these leases to reflect minor changes in the volume of sales from the uncommitted (segregated) lands which resulted in additional royalty payments to MMS. In the revised forms, appellant reversed the \$7,544.57 payment for lease 48-0266642-0, and applied those funds along with an additional \$41.15 payment to lease 049-085360-0, the number of the segregated lease. Appellant also reversed the \$1,288.80 payment for lease 48-266641-0 and applied those funds and an additional \$9.91 payment to lease 049-85359-0, the newly segregated lease.

By invoice 07500553, dated September 4, 1985, MMS assessed appellant \$1,631.15 in interest for late royalty payments for various leases, including charges for interest from July 1984 to February 1985 for the royalty amounts for June 1984 which appellant credited to leases 049-085360-0 and 049-085359-0 in February 1985. By letter dated October 1, 1985, appellant appealed to the Director, MMS, the interest demand only

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<sup>1/</sup> Appellant asserts this breakdown in communications is typical because BLM only notifies the lease operator of the segregation. Phillips is not the operator for these leases. Copies of the BLM lease segregation letter/decisions for each of these leases show they were addressed to several parties but not to appellant.

insofar as it pertained to the sums timely paid, i.e., the \$7,544.57 and the \$1,288.80 payments. Appellant explained that those payments originally had been paid timely, but had been reversed from the original leases and charged back to the segregated leases. Appellant stated that "[a]s the lease number changed, the MMS did not allow credit for the amounts reversed." Appellant paid the interest demand under protest.

In his March 24, 1987, decision, the Assistant Director first stated that the Government's policy is to assess a late payment charge on all debts not received by the due date, and noted that both section 111 of the Federal Oil and Gas Royalty Management Act of 1982 (FOGMRA), 30 U.S.C. | 1721 (1982), and 30 CFR 218.54 and 218.102 grant MMS the authority to assess interest on untimely payments. He noted that appellant stated that the royalties were timely tendered, but were directed initially to the wrong account. The Assistant Director acknowledged MMS' policy of charging a reporting error assessment pursuant to 30 CFR 218.40, rather than late payment charges, when an otherwise timely royalty payment is misidentified on a Form MMS-2014, provided that the payor has correctly identified the lease for which payment was made. In this case, however, since the leases for which appellant's payments were intended were not properly identified, the Assistant Director determined that this policy was not applicable.

The decision characterized appellant's position as seeking to offset an overpayment on one lease with the resulting underpayment on another. The Assistant Director stated that, to increase efficiency and to ensure compliance with laws and regulations requiring timely disbursements to states, Indian tribes, and allottees, "MMS does not recognize, within the context of 30 CFR | 218.54, the netting or offsetting of overpayments and underpayments between leases that are not included in a unit or communitization agreement" (Decision at 2). MMS cited three practical considerations supporting its decision to limit offsetting to a single lease:

First, leases are separate contracts, issued individually. It is the lease agreement which binds the lessee to pay royalty to the lessor, and the royalty provisions of one lease may vary from those of another. Treating each lease account as a single account for purposes of offsetting is consistent with the nature of the royalty obligation under the lease.

Second, the MMS accounting system, while payor oriented, is designed to account for an individual payor on a single lease. To require MMS to alter its accounting system to one which would account on a company basis, no matter how many leases the company holds, would be unmanageable and inefficient.

Finally, offsetting between leases is not workable in light of the fact that 50 percent of the royalties collected are paid to the State in which the lease is located. Offsetting overpayments on one lease against underpayments on another lease (even if the

result of a clerical error) could permit a payor to credit an overpayment on a lease in Utah against an underpayment on a lease in Colorado. If the lessee pays no interest, this would result in Colorado losing the time value of the money to which it was entitled.

(Decision at 3).

The Assistant Director concluded that, since there was no evidence that the leases here were part of the same unit or communitization agreement, MMS properly assessed interest on the payments at issue. Accordingly, he denied the appeal. Appellant has appealed this decision to the Board.

In its statement of reasons, appellant recognizes that MMS has statutory and regulatory authority to assess interest, and that the purpose of the late payment charge is to compensate for the replacement cost of funds due but not timely paid. It argues, however, that the authority to assess interest is limited to only two circumstances: "[W]here there is an under-payment and when the payment is not timely received" (Statement of Reasons at 3). Because MMS had the funds at issue here by the due date, appellant contends that MMS cannot argue that it is entitled to interest to compensate for amounts not timely paid or for the time value of the money.

Appellant further argues that this case is not an offset between leases. Rather, appellant contends that this situation concerns the same production from the same lease acreage, not different leases in different states. Therefore, the policy arguments advanced by MMS to justify its interest demand are inapplicable. Appellant also alleges that MMS' action in demanding interest here is inconsistent with its own policy of charging an assessment (liquidated damages), rather than interest, when an error is made in identifying a payment. Appellant asserts that, in effect, this interest demand is actually a penalty.

In its answer, MMS counters that the payments were not timely because they were credited to the incorrect lease. In support of its determination to assess late payment charges when a payment is credited to an incorrect lease which is not part of the same unit, MMS reiterates the policy considerations discussed in its decision. It contends that the distinction between leases in a unit and those not in a unit flows logically from the nature of the unit agreement, which overrides the separate lease agreements, and provides for the operation of the entire acreage as a whole, thus negating the accounting problems presented by offsets between leases not in the same unit.

MMS also argues that its actions were consistent with its policies, and that it was proper to charge interest here, rather than to assess appellant for erroneous reporting. "[W]hen an incorrect lease number on Form MMS-2014 causes the royalty payment to go to a lease outside of the proper

unit, it is MMS's policy to assess late charges, rather than the \$10.00 per line erroneous reporting assessment" (Answer at 5). Additionally, MMS asserts that, since the interest was properly assessed, it clearly was not a penalty.

In reply, appellant repeats that MMS timely received the money even if it was not credited to the correct lease. Appellant argues that its initial failure to credit the payments correctly was not its fault. Appellant notes that it did not receive notice from BLM that the leases had been segregated until July 1984, and that, as soon as it became aware of the segregation, it filed PIF's with MMS identifying the new lease numbers. Appellant asserts that use of the new lease numbers required receipt of PCR's confirming the new lease numbers which MMS provided on July 29 and August 12, 1984. Appellant contends that, because MMS had the use of the funds, it cannot claim to have lost the time value of the money, and no interest should have been assessed.

Appellant emphasizes that there was no offset between leases because the royalty is paid for production from certain producing acreage which did not change. A change in the number of the segregated portion of the lease, of which appellant received notice too late to use on the June 1984 royalty payment, does not make this an offsetting royalty situation. Therefore, none of the policy reasons advanced by MMS has any bearing on the specific facts at issue. Appellant argues that MMS' application of its administrative convenience policy to the facts of this case is arbitrary and capricious, and that MMS has failed adequately to explain its action and to articulate a rational connection between the facts of this case and its decision.

[1] Section 111(a) of FOGMRA, 30 U.S.C. | 1721(a) (1982), specifically provides, in the case of oil and gas leases, that "where royalty payments are not received \* \* \* on the date that such payments are due, or are less than the amount due, the Secretary shall charge interest on such late payments or underpayments." Departmental regulations at 30 CFR 218.54 and 218.102 provide further authorization for the assessment of late payment charges. Appellant does not challenge MMS' authority to assess interest for late payments, but it argues that, under the circumstances here, the payments were timely and, therefore, that no interest should have been assessed. We agree.

It is uncontradicted that, had there been no segregation of the leases, the royalty payments would have been timely. The question is whether, under the facts of this case, the segregation of the leases rendered those otherwise timely payments untimely.

When only part of a lease is committed to a unit agreement, the uncommitted portion of the lease is segregated into a new lease and given a new lease number. 30 U.S.C. | 226(m) (1982). The Department has held in the

past that delays in receipt of notice of segregation of a lease as a result of unitization will not be allowed to prejudice the rights of the lessee. Thus, where the lessee of a producing oil and gas lease was not informed of the approval of a unit agreement which included the acreage embracing the producing well and the resulting segregation of the balance of the lease acreage into a nonproducing lease requiring payment of rental annually before the lease anniversary date, the lease was held not to have terminated for failure to pay the rental by the anniversary date. Husky Oil Company of Delaware, 5 IBLA 7, 79 I.D. 17 (1972). <sup>2/</sup> Similarly, where an oil and gas lease in a royalty status by reason of a productive well is segregated by assignment of the acreage containing the well, the base lease was held not to terminate for failure to pay annual rental before the lease anniversary date if BLM does not inform the lessee of the segregation until after the anniversary date. Odessa Natural Corp., 30 IBLA 28 (1977).

The segregation does not change the terms or conditions of the lease; rather the terms of the base lease carry over and are incorporated into the newly created lease. See T. Jack Foster, 75 I.D. 81, 88 (1968). Therefore, the royalty provisions of lease 48-0266642-0 and the segregated lease 049-085360-0 are identical, as are the royalty provisions of lease 48-0266641-0 and its segregated lease 049-085359-0. Thus, MMS' offset policy rationale focusing on the differing royalty provisions of different leases has no relevance to the specific facts of this case.

Similarly, none of the other policy considerations advanced by MMS support the assessment of interest in this particular case. As appellant states, the royalty payments at issue here were for the same production from the same acreage. Thus, royalty payments to only one state are involved, so there is no problem with a state losing the use of money due to it.

The record reveals that, under the unique circumstances presented here, there was not an offset between two different leases; rather only a single lease was involved. Appellant simply sought credit for payments it made on the same lease acreage before it learned that a different serial number had been assigned to the lease acreage due to the segregation. Thus this case is distinguishable from cases where there is truly an attempted offset between two unconnected leases. See, e.g., Sun Exploration & Production Co., 106 IBLA 300 (1989). Whereas MMS' policy considerations may have validity in the situation where two such different leases are involved, we agree with appellant that those policy considerations do not apply to the distinct circumstances found here. Because the disputed royalty payments were timely received by MMS, no interest should have been assessed for those payments.

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<sup>2/</sup> Significantly, the Board noted in Husky that until receipt of notice of the segregation and the lease number assigned to the segregated lease, the lessee would not have a lease number with which to properly identify the rental payment. This same problem precluded appellant in the present case from identifying the June 1984 royalty payments as belonging to the segregated leases.

Accordingly, pursuant to the authority delegated to the Board of Land Appeals by the Secretary of the Interior, 43 CFR 4.1, the decision appealed from is reversed.

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C. Randall Grant, Jr.  
Administrative Judge

I concur:

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Anita Vogt  
Administrative Judge  
Alternate Member